SUPREME COURT, U.S.

73-663

OCT 17 1973

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1973

No. A-181

WILLIAM R. WESSON, a CLASS B STOCKHOLDER in MISSOURI PACIFIC RAILROAD COMPANY, for himself and all others similarly situated,

Appellant,

v.

BETTY LEVIN, on behalf of herself and all other holders of CLASS B COMMON STOCK of MISSOURI PACIFIC RAILROAD COMPANY, and on behalf of said corporation, and ROBERT LE VASSEUR and ALLEGHANY CORPORATION,

Plaintiffs-Appellees,

against

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS MILBANK,

Defendants-Appellees.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

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Defendants Appellees.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner-appellant, William R. Wesson, seeks a writ of certiorari to review a judgment of the United States Court of Appeals for the Second Circuit. That Court by a 3 to 0 vote affirmed a judgment of the District Court for the Southern District of New York (a) approving a settlement of the class action maintained by the plaintiffs-appellees (above captioned), as representatives of the Class B stockholders of Missouri Pacific, and (b) an order of said District Court dated and entered April 10, 1973, denying petitioners motion requesting that said judgment not be binding on appellant and other Class B stockholders of MoPac similarly situated.

Opinion Below

The judgment of the Court of Appeals below appears in A 2, and the adopted opinion of the District Court upon which said judgment was based appears at A 4. The opinion has not, as far as petitioner knows, been reported.

Jurisdiction

The judgment of the Court of Appeals was entered on June 12th, 1973. The judgments of the District Court were dated May 2nd, 1973 and April 10th, 1973 respectively, the opinion approving the settlement of the class suit having been given on March 19th, 1973.

The Supreme Court of the United States by order dated August 24th, 1973, extended petitioners time for filing a petition for writ of certiorori to October 17th, 1973.

This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1), the jurisdiction below having been based on diversity of citizenship, 28 U. S. C. 1332(a).

Questions Presented

1. Did not the Court of Appeals err in affirming the District Court's judgment in approving, pursuant to Rule 23 F. R. C. P., the compromise of the class suit instituted by plain-

tiffs-appellees and holding that said compromise was binding on petitioner and other Class B stockholders of MoPac similarly situated when: (a) the original class suit was for increased dividends for Class B stockholders of MoPac, (several, non-joint claim, or spurious class), and the compromise required those represented to give up their property rights in their Class B stock, which rights were never in jeopardy in the class suit?;

(b) a value of $2,450 per share was placed on petitioners stock without an opportunity for a hearing for appraisal, contrary to the due process requirements of our law?;

(c) the plaintiffs-appellees in entering the stipulation of settlement with the defendants-appellees sell and bargain away that which was not theirs—viz. the property rights of petitioner and those similarly situated in the ownership of Class B stock of MoPac?;

(d) the plaintiffs-appellees were not representative of petitioner's interest and that of other Class B stockholders similarly situated?;

(e) the compromise settlement exceeded the jurisdiction of the court in that it went far beyond the issues in litigation, constituted a business negotiation and confiscated personal property rights of the petitioner in his shares of Class B stock?;

(f) the judgment approving the settlement was contrary to the spirit of Rule 23 F. R. C. P., grossly unfair, and contrary to the opinion of this court in its 1967 decision [386 U. S. 162].

2. Whether the subsequent MoPac stockholders vote on the recapitalization compromise should be held to rectify the courts error in approving the compromise when said voting was held under the aura, dignity and prestige of the courts prior approval and recommendation of the compromise?

Rules Involved

Rule 23 of the Federal Rules of Civil Procedure provides in pertinent part:

Rule 23.

CLASS ACTIONS

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

* * *

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.
As amended Feb. 28, 1966, eff. July 1, 1966.

Statement and Reasons for Granting the Writ

A most important question of Federal Law, viz. clarification of Rule 23(e), (Dismissal or Compromise of Class actions), is presented by this petition. This question has not been but should be reviewed and settled by this Court.

Should a court, under Rule 23(e), approve a compromise of a spurious class suit by stockholders for better dividends when said compromise calls for recapitalization which in turn requires, over objection, that the represented stockholders give up their property rights in their stock which property rights were never in jeopardy or in issue in the original litigation?

The Courts below felt that such compromise was proper. If this interpretation is allowed to stand uncorrected by this Court, no property owner can feel secure in his ownership. Any representative of a spurious class can maintain an action for one claim, and in settlement bind and bargain away the individual property rights of the represented, which rights were not in danger in the initial suit.

A hypothetical situation, which clearly sets forth what happened here, would be as follows: several owners of homes on a city block sue the city as a class to have their own tax assessments reduced as well as the assessments of all their neighbors. The class plaintiffs then settle their suit with the city by selling to the city their own and their neighbors homes at a price fixed by the representatives and over the objection of the neighbors.

The original action, based upon diversity of citizenship jurisdiction, was commenced in December 1967 by Betty Levin against the defendants-appellees.

The essence of Ms. Levin's suit was that she, as an owner of Class B stock of MoPac, was not receiving proper dividends due to alleged wrong doings by the defendants-appellees.

Thereafter the other plaintiffs-appellees, Class B stockholders of MoPac joined and/or intervened in the suit of Ms. Levin.

On October 9, 1968 plaintiffs-appellees suit was declared a class action by the Federal District Court S. D. N. Y., and a short limited time ending December 20, 1968 was provided for petitioner and other Class B stockholders similarly situated to intervene in the Levin suit for better dividends.

Petitioner, feeling secure that the ownership of his class B stock was not in jeopardy in the Levin class suit for better dividends, and that he could in no manner be adversely effected by said suit, did not intervene.

However, much to the shock of petitioner, and other Class B stockholders of MoPac similarly situated, the plaintiffs-appellees, violating and abusing, or at very least exceeding their trust as class representatives of a spurious cause of action for better dividends, abandoned their suit and entered a stipulation of settlement on December 18, 1972 with the defendants-appellees which required a recapitalization of MoPac. This settlement required the petitioner and other Class B stockholders of MoPac to give up their ownership of their Class B stock at a price fixed without a valuation hearing at $2450 per share, and reduced the equity of MoPac of Class B shares from 65.5% to

25.5% and transferred it to the Class A shares, increasing their equity from 34.5% to 74.5% after the settlement is finalized and upon full conversion of the new preferred. This in effect reduces the Class B equity by 61% as of December 31st, 1972, and transfers this B equity to the Class A shares.

In the October Term of this Court in 1966 such an equity transfer effort by the same parties with respect to the same stock, was rejected, repudiated, and criticized by this Court by an 8-0 decision. *Levin* v. *Mississippi River Corp. et al; Alleghany Corp. et al* vs. *Mississippi River Fuel Corp. et al* (386 U. S. 162, 1967).

By judgment, dated May 2, 1973, the Southern District Federal District Court approved this settlement and the Court of Appeals (2nd Circuit) affirmed.

Not one case cited by the Courts below supports a settlement and/or compromise of a class suit which is so unfair and so far removed from the issues of the original suit, and requires the represented to give up their property rights which are independent of the original suit.

The unfairness of the settlement was not and could not be corrected or compensated by the subsequent vote of the stockholders. This subsequent voting, having been ordered by the court was tainted and defective. It was not a free vote of the stockholders because the voting was held under the aura of a judgment of the court approving the settlement plan. In effect the voting was by court fiat.

This is a case of first impression because of the amendment to Rule 23 and the doing away with the concept of true, hybred and spurious class actions.

If the claim pursued by the plaintiffs-appellees had been a joint claim owned by all the Class B stockholders the judgments below would not be unfair. But because the claim was not joint the plaintiffs-appellees could not reach into the pockets of the petitioner and others similarly situated to settle their suit. To

have done so is to have worked a grave and serious injustice which must be corrected by this court.

Dated: Brooklyn, N. Y.
October 17, 1973

Respectfully submitted,

GERARD M. CAREY,
Counsel for Petitioner.

WILLIAM R. WESSON,
Petitioner.

Order Extending Time to File Petition for Writ of Certiorari

Supreme Court of the United States

No. A-181

WILLIAM R. WESSON, et al.,

Petitioners,

v.

BETTY LEVIN, etc., et al., and MISSISSIPPI RIVER CORP.,

Defendants.

UPON CONSIDERATION of the application of petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including October 17, 1973.

/s/ WILLIAM H. REHNQUIST
Associate Justice of the Supreme Court of the United States

Dated this 24th day of August, 1973

A 2

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twelfth day of June one thousand nine hundred and seventy-three.

PRESENT: HON. IRVING R. KAUFMAN, Chief Judge,
HON. J. JOSEPH SMITH, Circuit Judge,
HON. FREDERICK P. BRYAN, District Judge.

73-1864
73-1865

BETTY LEVIN, on behalf of herself and all other holders of the Class B Common Stock of Missouri Pacific Railroad Company, and on behalf of said corporation and ROBERT LEVASSEUR and ALLEGHANY CORPORATION,

Plaintiffs,

WILLIAM R. WESSON, a Class B Stockholder in MISSOURI PACIFIC RAILROAD COMPANY,

Plaintiff-Appellant,

v.

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS F. MILBANK,

Defendants-Appellees.

Judgment

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed on Judge Weinfeld's opinion below, —— F. Supp. —— (S. D. N. Y. 1973).

IRVING R. KAUFMAN
Chief Judge

J. JOSEPH SMITH
Circuit Judge

FREDERICK P. BRYAN
District Judge

A 4

Opinion of Edward Weinfeld, D. J.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

67 CIVIL 5095

BETTY LEVIN, ALLEGHANY CORPORATION and ROBERT LEVASSEUR,

Plaintiffs,

against

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS F. MILBANK,

Defendants.

EDWARD WEINFELD, D. J.

This is a motion pursuant to Rules 23 and 23.1 of the Federal Rules of Civil Procedure for approval of a settlement agreement of a class action brought on behalf of Class B stockholders of the Missouri Pacific Railroad Company (MoPac), an interstate railroad. The plaintiffs in the class action are Alleghany Corporation (Alleghany), the owner of a majority of the outstanding shares of Class B stock, and two individual owners of such stock, Betty Levin (Levin) and Robert LeVasseur (LeVasseur), who also assert derivative claims on behalf of and in the right of MoPac. The defendants include Mississippi River Corporation (Mississippi), the owner of a majority of the outstanding Class A stock of MoPac, and three individual defendants, directors of MoPac, two of whom are also directors of Mississippi. In the event the proposed settlement is approved, applications for allowance of attorneys' fees and expenses are to be considered following entry of final judgment.

A 5

Historical Background of the Class A and Class B Stock

The capitalization of MoPac has been the subject of controversy and litigation for almost forty years. The Class A and Class B stockholders have been at odds over their respective rights and interests over a substantial period. Their differences were accentuated by MoPac's restructured capitalization when in 1956 it emerged from reorganization proceedings filed in 1933. During those twenty-three years various proposed plans of reorganization failed to gain acceptance. Alleghany Corporation, the owner of about half of MoPac's then outstanding common stock, had opposed reorganization plans proposed in 1940, 1944 and 1949 because none provided for the old common stockholders. Finally, a fourth plan, referred to as an "Agreed System Plan," was proposed by the reorganization Trustee, approved by the Interstate Commerce Commission in 1954, accepted by Alleghany and other interests, and became effective March 1, 1956.[1] The plan, which then seemed to be an ingenious way to compose differences among various security and equity interests, contained provisions which some objectors predicted "are sure to cause trouble."[2] And so it has come to pass. Missouri Pac. R. R. Reorganization, 290 I. C. C. 477, 624-25 (1954). The equity interests have been at odds and in litigation ever since.

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[1] Missouri Pac. R. R. Reorganization, 290 I. C. C. 477 (1954), *approved in In re* Missouri Pac. R. R., 129 F. Supp. 392 (E. D. Mo.), *aff'd sub nom.* Missouri Pac. R. R. 5¼% S. S. B. C. *v.* Thompson, 225 F. 2d 761 (8th Cir. 1955), *cert. denied,* 350 U. S. 959 (1956).

[2] *In re* Missouri Pac. R. R., 129 F. Supp. 392, 397 (E. D. Mo. 1955). ICC Commissioner Mahaffie was the first to predict trouble ahead. In his reluctant concurrence of the reorganization plan, he said:

> "The prior class 'A' stock is limited as to dividends and is noncumulative. It will be largely of a speculative character for some years at best. But the 'B' stock is for the present, and for the foreseeable future, principally valuable as a token for speculation. Consequently, its relation to the 'A' stock and to the debentures and income bonds which precede it is reasonably sure to cause trouble."

MoPac's recapitalization upon its reorganization was structured so that the old preferred and common stock were replaced by two classes of stock, Class A and Class B. The Class A shares of the reorganized company were issued to the former preferred stockholders of MoPac, the debtor, with each share entitled to receive, when and as declared by the Board of Directors, noncumulative dividends, not to exceed $5 annually, and in the event of dissolution or liquidation, the first $100, together with any dividends declared and unpaid. The Class B shares were issued to the former common stockholders of the debtor, and after payment of the $5 dividend to the Class A stock, each share of Class B stock is entitled to receive dividends, without restriction, as the Board of Directors may declare, and upon liquidation or dissolution of MoPac, the equity in excess of the Class A preferences. Each share of each class is entitled to one vote. The former preferred stockholders received approximately 1.9 million shares and the former common stockholders received approximately 40,000 shares, so that 98% of the voting stock is held by the Class A stock and 2% by the Class B stock.

Obviously, the Class A stockholders have the power to elect MoPac's Board of Directors, as well as voting control with respect to other but not all corporate matters. On mergers, consolidations or reorganizations involving issuance of additional stock or the alteration of the rights of either class, approval by a majority of each class is required. Thus, in effect, the Class B stock has a veto power over such actions. In practical terms, the "ingenious" solution envisaged under the 1956 reorganization created a basic conflict between the two classes, with the equity ownership principally in the B stock, but with effective operating control in the A stock.

Mississippi began acquiring Class A stock in 1959 and by 1963 owned more than one million shares, constituting 58% of the outstanding Class A shares. It now owns 63%, or 1,158,395 shares out of a total outstanding of 1,864,052. Since 1963 it has elected the Board of Directors of MoPac. Alleghany, on the other hand, which has owned a majority of the outstanding Class B stock ever since it was issued upon the reorganiza-

tion, now owns, subject to a voting trust, approximately 53%, or 21,243 shares, of the total outstanding 39,731 shares. Thus the disparity of interest between the two classes of stock is further aggravated by Alleghany's majority ownership of the B stock, which gives it an independent veto power over any corporate action that requires the separate approval of the B stock.

The Voting Rights Litigation

The first litigation that the differing stockholders became embroiled in after the reorganization came in December 1963, when MoPac's Board of Directors proposed the consolidation of MoPac and its 83% owned subsidiary, Texas and Pacific Railway Company (T&P), into a new corporation, Texas and Missouri Pacific Railroad Company (T&M). An application was filed with the Interstate Commerce Commission for an order under section 5(2) of the Interstate Commerce Act authorizing the proposed consolidation and for the issuance of securities by T&M under section 20a of the Act. The plan provided for an exchange of each MoPac share, regardless of class, for four shares of the new corporation and for an exchange of the T&P stock (other than that owned by MoPac) on the basis of one share of T&P for 4.8 shares of the new company. MoPac's Board of Directors took the position that the Class B stockholders were not entitled to vote on the plan separately and apart from the Class A stockholders, and that it intended to submit the plan for approval to the collective vote of the Class A and Class B stockholders. In view of Mississippi's ownership of a majority of the Class A stock, as well as all outstanding stock, the outcome of the vote on consolidation was virtually foreordained. Alleghany and other Class B stockholders filed actions in the United States District Court for the Eastern District of Missouri for a declaratory judgment that the plan required the approval of a majority of each of the two classes of stock and sought other relief. Upon a limited consolidation of the cases the district court held that MoPac's Articles of Association and the applicable federal and state law required the separate ap-

proval of each class of shareholders.[3] The Court of Appeals reversed, holding that separate class approval was not required.[4] On certiorari, the Supreme Court unanimously reversed the Court of Appeals, holding that:

> "With reference to voting rights, we hold only that in a consolidation as proposed here, Missouri law must be applied and . . . that law requires the application of the Articles of Association of MoPac, which in turn, require the assent of the majority of the shareholders on a separate class-vote basis."[5]

Since a number of stockholders emphasize certain rhetorical statements in the Court's opinion,[6] it is well to bear in mind the Court's precise holding, and further its statement: "We do not . . . reach the merits of the proposed plan. . . ."[7] The Court's ruling ended the proposed consolidation when in March 1967 MoPac and T&P abandoned their plan, but further litigation was ahead.

The Instant Action

This action was instituted by plaintiff Levin in December 1967. Thereafter Alleghany and LeVasseur intervened pursuant to leave granted by this Court. In September 1968 Judge Bryan ordered that the action be maintained as a class action on behalf of all Class B stockholders. The thrust of the complaints of all three plaintiffs is directed toward the dividend policy with respect to the Class B Stock. From 1964 to 1971 the annual dividends paid on the A stock have been $5 per share. During that same

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[3] Slayton *v.* Missouri Pac. R. R., 233 F. Supp. 747 (E. D. Mo. 1964).

[4] Mississippi River Fuel Corp. *v.* Slayton, 359 F. 2d 106 (8th Cir. 1966).

[5] Levin *v.* Mississippi River Fuel Corp., 386 U. S. 162, 170 (1967).

[6] *See, e.g., id.* at 169: "The plan proposes to exchange four shares of stock of T&M for one share of MoPac Class B, which . . . is like exchanging four rabbits for one horse."

[7] *Id.* at 170.

period annual dividends declared and paid on the Class B stock have been $5 per share.

In substance, three separate claims are asserted against Missippi and the three individual defendants.[8] Under the first cause of action plaintiffs claim that the dividends declared and paid by MoPac have been unreasonably low; that Mississippi has misused its majority voting stock power by causing MoPac's Board of Directors to limit dividends on the Class B stock to $5, the maximum permissible per share dividend payable on the Class A stock, despite the enormous differences in the equity value between the two classes, and notwitstanding the availability in each year of net income for increased dividends after meeting the requirements on the Class A stock.

The second cause of action charges a conspiracy by Mississippi and members of MoPac's Board of Directors to "freeze out" the Class B stockholders by improperly limiting the dividends paid on the Class B stock, making public statements denigrating the market value of the Class B stock, and attempting to appropriate the equity of the Class B stockholders through the plan of consolidation of MoPac with T&P, proposed in 1963.

The third cause of action further alleges that the various acts and conduct alleged in the second cause of action were in violation of section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5, promulgated thereunder, and of defendants' common law fiduciary duty owed the Class B stockholders. The plaintiffs seek judgment that the Court direct MoPac to pay reasonable dividends for the past years, from 1964 to 1971, to all Class B stockholders; that MoPac be directed to pay reasonable dividends on the Class B stock in the future; and to award plaintiffs their costs, expenses and reasonable counsel fees incurred in the prosecution of this action.

In addition to the class action claims, Levin and LeVasseur separately assert derivative claims on behalf of MoPac. One

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[8] Plaintiff Levin also attacks the failure of defendants to split the Class B stock or to take similar steps to improve its marketability; however, no specific relief is sought.

alleges that the defendants have failed to cause MoPac to replace the Class A stock with debentures or other interest bearing securities, which would materially reduce MoPac's income tax; however, as to this derivative claim, no specific relief is sought. A further derivative claim on behalf of MoPac is for the recovery of the costs and expenses incurred by it in connection with the 1963 T&P consolidation plan and the Class B voting rights action.

The defendants in their answers have denied the material allegations of the complaints and set up affirmative defenses, including, with respect to the dividend cause of action, business justification.

With the issues thus posed, the parties engaged in extensive pretrial discovery procedures commencing in 1968. The case was assigned to this Court in midyear 1972, and after a pretrial conference the trial was scheduled to commence on December 4, 1972. As the trial date approached, the litigants had virtually completed all pretrial activities, which included depositions of parties and witnesses, as well as interrogatories propounded to one another, which in due course were answered. In addition, plaintiffs had obtained, read and evaluated approximately 10,000 pages of documents from the files of MoPac and related sources. The inspection of these documents took over ninety man-days' work by plaintiffs' counsel and additional time by an accountant and securities expert, retained specially for that purpose. It is evident that the pretrial discovery on both sides was as thorough as could be and all pertinent facts exposed by the litigants in preparation for a contested trial. While engaged in concluding their expanded pretrial activities, the parties concurrently intensified efforts to effect an amicable settlement. Previously, during the pendency of this case, and even before, attempts to reach an accommodation had failed. The renewed extended negotiations were participated in not only by the lawyers representing the parties, executives and financial officers of the corporations involved, but also by independent financial analysts and investment advisers specializing in corporate and transportation finance. The negotiators recognized that central to a lasting reso-

lution of the conflict between the two stockholder interests was the elimination of the underlying cause of the strife, a result not obtainable whatever the final outcome were the case to proceed to trial, and it was this concept which led to a settlement on the basis of a restructured capitalization.

The Terms of the Proposed Settlement

If the settlement is approved by the Court, a Plan of Recapitalization (Plan) and a proposed Amendment to MoPac's Articles of Association are to be submitted to stockholders for their approval, to bring about the following:

(1) each share of Class A stock would be converted into one share of $5 cumulative preferred stock, with a liquidating preference of $100 per share, convertible into one share of new common after one year following ICC authorization of the issuance of new securities and redeemable at the option of MoPac for $100 per share, after December 31, 1975. This would require the issuance of 1,864,052 shares of the new stock to the present holders of the Class A stock, of which Mississippi would be entitled to receive 1,158,395 shares;

(2) each share of Class B stock would be converted into sixteen shares of new common stock and $850 cash. This would require the issuance of 635,696 shares of new common stock to the present holders of Class B stock, of which Alleghany would be entitled to receive 339,888 shares; this would require a cash payment by MoPac of $33,771,350;

(3) both preferred stock and common stock would have one vote per share;

(4) the Plan and amendment would have to be approved by 75% of the outstanding shares of each class of MoPac stock, including a majority of the shares of each class other than those held by Mississippi and Alleghany —that is, a majority of the minority stockholders of each class;

(5) the issuance of the new shares would have to be approved by the Interstate Commerce Commission;

(6) upon such approvals, Mississippi is required to make a cash tender offer to all Class B stockholders for at least 400,000 shares (approximately 63%) of the new common stock, at $100 per share, and Alleghany (but not the minority B shareholders) must tender all its new common stock (339,888 shares). If more than 400,000 shares are tendered, Mississippi may purchase the shares on a pro rata basis; this would require a cash payment by Mississippi of at least $40,000,000;

(7) all claims asserted in this action and any other claims against the defendants which are based upon or arise from any of the matters alleged in the complaints, regardless of the legal theory upon which they are based, will be dismissed with prejudice;

(8) fees awarded to plaintiffs' attorneys will be paid by MoPac and Mississippi.

If the recapitalization and tender offer are not consummated by December 31, 1973, the settlement agreement would be terminable at the option of Alleghany, Mississippi or MoPac.

Evaluation of the Settlement

The function of the Court on this application for approval of the settlement is not, as some objectors suggested at the hearing and others have since urged in their communications to the Court, to reopen and enter into negotiations with the litigants in the hope of improving the terms of the settlement to meet their respective objections; nor is the Court called upon to substitute its business judgment for that of the parties who worked out the settlement.[9] So, too, the Court is cautioned not to turn the

[9] Schleiff *v.* Chesapeake & Ohio Ry., 43 F. R. D. 175, 178 (S. D. N. Y. 1967); Glicken *v.* Bradford, 35 F. R. D. 144, 151 (S. D. N. Y. 1964).

settlement hearing into a trial or a rehearsal of a trial.[10] To do so would defeat the very purpose of the compromise to avoid a determination of the sharply contested issues and to dispense with expensive and wasteful litigation. The Court's role is a more "delicate one,"[11] which requires a balancing of likelihoods rather than an actual determination of the facts and law in passing upon whether the proposed settlement is fair, reasonable and adequate to the Class B stockholders and MoPac.[12] This appraisal requires the Court to reach "an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated" and to "form an educated estimate of the complexity, expense, and likely duration of such litigation . . . and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance . . . is the need to compare the terms of the compromise with the likely rewards of litigation."[13] With that guidance, we turn to the task at hand.

At the outset is the simple fact that the interests of each class of stockholders is tied up with the welfare of MoPac. Its operating efficiency and its competitive strength spell out economic success, which alone gives value to its stock, whatever the class. MoPac is in competition with a number of railroads, some of which, following trends in the industry and consistent with the

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[10] Newman *v.* Stein, 464 F. 2d 689, 692 (2d Cir.), *cert. denied,* — U. S. — (1972).

[11] *Id.* at 691; see also United Founders Life Ins. Co. *v.* Consumers Nat'l Life Ins. Co., 447 F. 2d 647 (7th Cir. 1971).

[12] *See* Zerkle *v.* Cleveland-Cliffs Iron Co., 52 F. R. D. 151, 159 (S. D. N. Y. 1971).

[13] Protective Comm. *v. Anderson,* 390 U. S. 414, 424-25 (1968). *Accord,* Newman *v.* Stein, 464 F. 2d 689, 692 (2d Cir.), *cert. denied,* — U. S. — (1972). Saylor *v.* Lindsley, 456 F. 2d 896, 904 (2d Cir. 1972). West Virginia *v.* Chas. Pfizer & Co., 440 F. 2d 1079, 1085 (2d Cir.), *cert. denied,* 404 U. S. 871 (1971). With regard to weighing the benefits of the compromise against the likely rewards of litigation, *see* Purcell *v.* Keane, 54, F. R. D. 455, 460 (E. D. Pa. 1972); Glicken *v.* Bradford, 35 F. R .D. 144, 152 (S. D. N. Y. 1964). *But cf.* Norman *v.* McKee, 431 F. 2d 769, 774 (9th Cir. 1970), *cert. denied,* 401 U. S. 912 (1971).

congressional policy of encouraging consolidation of the nation's railroads into a limited number of systems,[14] have merged with other lines to effect economies and to improve efficiency. Other competitors are in the process of effecting consolidations. These merged, and the likely to be merged, competitors pose a potential threat to MoPac by depriving it of all but its short haul market and in other respects—as MoPac's chief executive officer states, "[it] could prove competitively ruinous." There can be little doubt that to maintain its competitive strength it is imperative that MoPac link itself with another system. Yet its efforts in this direction have been thwarted because of the disparate interests of the two classes of shareholders. Specific instances have been cited where other railroads have shied away from proposed consolidations because of the stockholders situation.

MoPac, to protect its competitive position against merged and other competing lines, has purchased through the years controlling securities of other railroads, a matter discussed hereafter. However, the stock acquisition method does not yield all the advantages of a merger. The elimination of the present capital structure with its built-in conflict between the two classes, which has foreclosed merger to date, will permit MoPac's officials to pursue merger prospects; it will also permit its officials to function full time in its interests and its stockholders'—thousands upon thousands of hours have been devoted to litigation instead of to railroad operations.[15]

Another benefit favoring the settlement is that it provides the effective means for payment of greater dividends and thus meets in part the demands of plaintiffs. The Board of Directors anticipates that the annual dividend rate will be $5 per share on each class of stock to be issued under the Plan. With the Class

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[14] *See* Penn Central Merger and N. & W. Inclusion Cases, 389 U. S. 486, 492 (1968); *see also* N. Y. Times, Feb. 16, 1973, at 1, col. 7.

[15] *Cf.* Denicke *v.* Anglo Cal. Nat'l Bank, 141 F. 2d 285, 288 (9th Cir.), *cert. denied,* 323 U. S. 739 (1944), Derdiarian *v.* Futterman Corp., 38 F. R. D. 178, 181 (S. D. N. Y. 1965).

B stockholders receiving sixteen shares of new stock for their present one share (in addition to the $850 cash), the dividend return will be $80 per annum as against the current $5 per share. Mississippi, committed to the purchase of at least 400,000 shares of the new common stock (apart from such additional common stock it may own by reason of conversion of its preferred after one year) would have an economic interest in the declaration of dividends on the new common stock.

Other advantages are evident. The conversion of the Class B stock into sixteen shares makes them more marketable and to this extent meets the derivative claim that the defendants failed to split the Class B stock, thereby broadening public interest in it. Additionally, at the present time the Class B stock elects no directors. Under cumulative voting the new common stock would have the means of representation on the Board of Directors.

We next consider a, if not the, most important factor—the probability of plaintiffs' success upon a trial, and, if successful, "the likely rewards of [the] litigation." The extensive pretrial discovery conducted by the parties has exposed their respective strengths and weaknesses.[16] While each litigant professes confidence in his cause, it is with recognition of the force of a countervailing position and also, as all are aware, that "[s]tockholder litigation is notably difficult and unpredictable."[17]

Plaintiffs have the burden of proof as to their claims. To prevail, they must establish under the allegations of their complaints that MoPac's Board of Directors, in subservience to the wishes of Mississippi, abused their discretionary powers and arbitrarily and unreasonably withheld dividends in each year, although MoPac's condition warranted such additional divi-

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[16] *Cf.* Saylor *v.* Lindsley, 456 F. 2d 896, 901 (2d Cir. 1972); Cherner *v.* Transitron Electronic Corp., 221 F. Supp. 48, 51 (D. Mass. 1963).

[17] Zerkle *v.* Cleveland-Cliffs Iron Co., 52 F. R. D. 151, 159 (S. D. N. Y. 1971); *cf.* Ferguson *v.* Birrell, 190 F. Supp. 506, 509 n.10 —(S. D. N. Y. 1960), *aff'd sub nom.* Ferguson *v.* Tabah, 288 F. 2d 665 (2d Cir. 1961).

dends.[18] Since the determination of whether a dividend should be declared rests in the first instance with the Board of Directors,[19] courts may intervene only when there has been bad faith, neglect or abuse of discretion.[20] This is indeed a heavy burden,[21] which plaintiff's experienced counsel frankly acknowledge. However, they stress that in each year after payment of debt, other corporate requirements and dividends on the Class A stock, substantial earnings were available to pay a much higher dividend than $5 on the Class B stock. This by itself, however, would not carry the day for the plaintiffs. The directors who were deposed swore that the declaration of dividends in each year was based upon prudent business judgment, which took into account MoPac's current and long range needs. This basically is the defense to plaintiffs' charges. The defendants emphasize that since the merger route was foreclosed to MoPac, it was essential, in order to protect its competitive position, to purchase large blocs of securities in other railroads, which required large cash expenditures; also that cash was used or required for equipment, up to date maintenance, capital improvement programs, current and projected, as well as other purposes vital to MoPac's competitive standing. To underscore their defense of prudent business judgment, the defendants refer to MoPac's Articles of Association which give the Board of Directors broad powers to set aside reserves and make such other provisions as the Board "shall deem to be necessary or advisable for working capital, for

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[18] *Cf.* Guttman *v.* Illinois Cent. R. R., 91 F. Supp. 285 (E. D. N. Y. 1950), *aff'd* 189 F. 2d 927 (2d Cir.), *cert. denied,* 342 U. S. 867 (1951); W. Q. O'Neall Co. *v.* O'Neall, 108 Ind. App. 116, 25 N. E. 2d 656 (1940); Dodge *v.* Ford Motor Co., 204 Mich. 459, 170 N. W. 668 (1919); Walsh *v.* Walsh, 285 Mo. 181, 226 S. W. 236, 245 (1920); Patton *v.* Nicholas, 154 Tex. 385, 279 S. W. 2d 848 (1955).

[19] *See* Wabash Ry. *v.* Barclay, 280 U. S. 197, 203 (1930); *see also* New York, L. E. & W. R. R. *v.* Nickals, 119 U. S. 296, 307 (1886).

[20] *See* Dodge *v.* Ford Motor Co., 204 Mich. 459, 170 N. W. 668, 681-82 (1919); 11 W. Fletcher, Private Corporations § 5325 (rev. ed. 1971) and cases cited therein.

[21] Staats *v.* Biograph Co., 236 F. 454, 457 (2d Cir. 1916).

expansion of the business of the Company . . . and for any other purpose of the Company."[22] The Court has reviewed the pre-trial material on the issue of prudent business judgment and the defendants' position thereon cannot be said to be lacking in substance. In any event, it points up the issue as a substantial one to be resolved upon a trial. Plaintiffs, upon the whole case, would have the burden of establishing that the directors, notwithstanding the explanation of the factors which influenced their judgment, were in fact acting in bad faith or in an arbitrary manner. Directors are permitted a very liberal discretion in determining matters of business policy.[23] And if that discretion has been exercised in good faith, that it may have been injudicious or even if the Court believed a different policy were desirable, would not, by itself, be sufficient to sustain plaintiffs' burden.[24]

Moreover, even if plaintiffs should prevail upon the merits on the issue of additional dividends, it would not necessarily mean a total recovery. The Court would face the question of determining what would have constituted adequate dividends *in each year* during the period from 1964 through 1971—a decision requiring consideration of numerous variables, making the likelihood of substantial recovery questionable. The problem, as acknowledged by all parties, is difficult of solution. As counsel for Alleghany recognizes:

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[22] MoPac's Articles of Association, Article VII D(1).

[23] *Cf.* Fielding *v.* Allen, 99 F. Supp. 137, 142 (S. D. N. Y. 1951); Dodge *v.* Ford Motor Co., 204 Mich. 459, 170 N. W. 668, 681-82 (1919); Park *v.* Grant Locomotive Works, 40 N. J. Eq. 114, 117-18, 3 A. 162, 165 (Ch. 1885), *aff'd,* 45 N. J. Eq. 244, 19 A. 621 (Ct. Err. & App. 1888); Leslie *v.* Lorillard, 110 N. Y. 519, 532, 18 N. E. 363, 365 (1888); Casey *v.* Woodruff, 49 N. Y. S. 2d 625, 643 (Sup. Ct. 1944).

[24] *Cf.* Taussig *v.* Wellington Fund, Inc., 313 F. 2d 472, 479 (3d Cir.), *cert. denied,* 374 U. S. 806 (1963); Everett *v.* Phillips, 288 N. Y. 227, 43 N. E. 2d 18 (1942); Bourne *v.* Bourne, 240 N. Y. 172, 177-78, 148 N. E. 180, 181 (1925); Gallagher *v.* New York Dock Co., 19 N. Y. S. 2d 789, 800-01 (Sup. Ct. 1940), *aff'd,* 263 App. Div. 828, 32 N. Y. S. 2d 348 (2d Dep't 1942); *see also* Briggs *v.* Spaulding, 141 U. S. 132 (1891); Masterson *v.* Pergament, 203 F. 2d 315, 330 (6th Cir.), *cert. denied,* 346 U. S. 832 (1953).

> "Thus, if a finding of wrongdoing were made, there would remain the problem of proving the amount of additional dividends which should have been paid. The effect of this difficult problem of proof on the outcome of the lawsuit might well depend upon which party was deemed to have the burden of proof. If plaintiffs were required to prove that the dividends paid by MoPac were inadequate, that burden could have remained unmet and recovery could have been denied. On the other hand, if defendants were required to prove the adequacy of the dividends paid, they might well have failed to meet that burden, and as a result plaintiffs might have won a substantial recovery."[25]

Plaintiffs' problems are further compounded since it is doubtful that the Court would retain jurisdiction, as plaintiffs request, in order to monitor the MoPac Board's future dividend policy which, initially, is the Board's responsibility. Such future judicial supervision of MoPac's dividend policy would require the Court to make complex business decisions from year to year as to amounts to be retained out of earnings in order to determine the net income available for the declaration of dividends. In end result, were the Court to retain jurisdiction, it would be required to function as MoPac's sole director in place of its duly elected Board of Directors.

Some objectors cite *Dodge* v. *Ford Motor Co.*[26] as giving strength to plaintiffs' position. However, that court adopted the general principle against judicial intervention in corporate affairs. The *Dodge* court did conclude that plaintiffs had produced sufficient evidence to prove that the directors were running the corporation for the benefit of persons other than the stockholders and therefore justified in requiring the payment of reasonable dividends. The facts of the *Dodge* case are by no means similar to those in the instant case. Similarly, *Mayflower Hotel Shareholders Protective Committee* v. *Mayflower Hotel Corp.*[27]

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[25] Affidavit of M. Lauck Walton, Jan. 23, 1973, at 23.
[26] 204 Mich. 459, 170 N. W. 668 (1919).
[27] 173 F. 2d 416 (D. C. Cir. 1949).

merely demonstrates that the plaintiffs have alleged a valid cause of action, not necessarily a successful one.

As to the conspiracy charge—that Mississippi conspired with others by various acts and means to "freeze out" the Class B stockholders or to depress the market price of the stock—plaintiffs face perhaps an even heavier burden, since it is conceded that no tangible or direct evidence has thus far been unearthed to sustain the charge; perforce, plaintiffs would have to rely upon circumstantial evidence and urge that the fact finder draw inferences therefrom of wrongful motive and conspiratorial conduct.

The third cause of action, based upon defendants' acts and conduct in connection with the alleged conspiracy to "freeze out" the B shareholders and allegedly resulting in violations of section 10(b) of the Securities Exchange Act, the rule thereunder and defendants' common law fiduciary duties, also presents problems of proof to plaintiffs. Plaintiffs here charge that during the existence of the alleged conspiracy Mississippi and the defendant T. C. Davis bought and sold shares of B stock; that the objective of the scheme was to depress the market of the B stock, thereby forcing plaintiffs to sell at prices much below their true value. Even considering the current liberalization of Rule 10b-5,[28] and that plaintiffs' position may have some support,[29] plaintiffs must carry the burden of proving that defendants' actions were fraudulent[30] or unjustified,[31] and that such conduct in some way caused plaintiffs' injury.[32] As to the latter,

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[28] *See, e.g.*, Affiliated Ute Citizens *v.* United States, 406 U. S. 128 (1972); Superintendent of Ins. *v.* Bankers Life & Cas. Co., 404 U. S. 6 (1971).

[29] *See* Cochran *v.* Channing Corp., 211 F. Supp. 239 (S. D. N. Y. 1962).

[30] *See* List *v.* Fashion Park, Inc., 340 F. 2d 457 (2d Cir.), *cert. denied*, 382 U. S. 811 (1965).

[31] As to justification, the same problems will be encountered here as in the dividend cause of action.

[32] *Cf.* Superintendent of Ins. *v.* Bankers Life & Cas. Co., 404 U. S. 6, 12-13 (1971); Mutual Shares Corp. *v.* Genesco, Inc., 384 F. 2d 540, 546 (2d Cir. 1967).

it is interesting to note that plaintiffs do not seek separate relief on their 10b-5 claim; instead, they urge that the damages be measured by the amount of reasonable dividends allegedly withheld by the defendants during 1964-1971. By invoking this measure of damages, plaintiffs also face the same problems already discussed as to the extent of recovery under the dividend cause of action.

As to the derivative causes of action, one claim seeks to hold Mississippi and the individual defendants accountable for the expenses incurred by MoPac in connection with the plan to consolidate MoPac with T&P, which was abandoned following the Supreme Court decision. Even were the plaintiffs to establish that the proposed consolidation was not in MoPac's interest but calculated to favor Mississippi,[33] the likelihood of recovery on this claim is diminished by the holding by the Eighth Circuit Court of Appeals that MoPac was not responsible to the plaintiffs for their legal fees and expenses in the voting rights litigation.[34] Additionally, plaintiffs would be hard put to prove that the proposed consolidation of MoPac with T&P was not a justifiable business decision by the MoPac Board. As already noted, the Supreme Court expressly disavowed that it passed upon the merits of the proposal.

To state all the foregoing, of course, is no forecast of result upon a trial. It is simply to recognize, as the principals themselves do, that the action presents many obstacles, particularly for plaintiffs, who have the burden of proof. With the defendants vehemently denying wrongful conduct, were the case to be tried, all the issues would be vigorously contested, with the outcome obviously uncertain. The probability of ultimate success at best can only be cautious prophecy.

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[33] As to the merits, the Court of Appeals for the Eighth Circuit recognized the issues in the voting rights litigation were complex and that no court had passed upon the fairness of the plan itself. Missouri Pac. R. R. *v.* Slayton, 407 F. 2d 1078, 1082, 1083 (8th Cir.), *cert. denied,* 395 U. S. 937 (1969).

[34] Missouri Pac. R. R. *v.* Slayton, 407 F. 2d 1078 (8th Cir.), *cert. denied,* 395 U. S. 937 (1969).

Having examined the benefits of the settlement and the prospect of success upon a trial, other factors merit consideration. As all parties stress, were the plaintiffs to prevail upon the trial, or whatever its outcome, there would still remain the root cause of the conflict between the two classes of stockholders—the separation between equity ownership (principally in the B stock) and management control (in the A stock). And as long as it exists there will be continued hostility between the two and the potential of renewed litigation. Its elimination will be an advantage to all concerned. The settlement also provides for the elimination of Alleghany's ownership of equity stock, which Mississippi is to acquire. With Alleghany no longer an opposing force, it should mean stability in management and operation of MoPac.

Another factor favoring the settlement, but by no means determinative,[35] is the unanimous judgment of all the parties, their counsel and their investment analysts and advisers that its terms are eminently fair. To be sure, the final judgment as to the fairness of the proposal is the responsibility of this Court, but their joint recommendation is entitled to substantial weight,[36] particularly so in the instant case. A unique situation exists here not present in the usual stockholders' suit recommended to the courts for settlement, where ofttimes the plaintiffs representing the class own a relatively small economic interest in the corporation. Alleghany's self-interest as the owner of 53% of the Class B stock gives some assurance that it negotiated to obtain the best possible terms for that group vis-à-vis the Class A stockholders.[37] The other two plaintiffs, minority Class B stockholders, each also owns a substantial number of shares reflecting a heavy investment in the stock. Their counsel have acted inde-

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[35] *Cf.* Cohen *v.* Young, 127 F. 2d 721, 725 (6th Cir. 1942).

[36] *See* Cannon *v.* Texas Gulf Sulphur Co., 55 F. R. D. 306, 316 (S. D. N. Y. 1971); Percodani *v.* Riker-Maxson Corp., 50 F. R. D. 473, 477 (S. D. N. Y. 1970); Schleiff *v.* Chesapeake & O. Ry., 43 F. R. D. 175, 179 (S. D. N. Y. 1967); Glicken *v.* Bradford, 35 F. R. D. 144, 152 (S. D. N. Y. 1964); Fielding *v.* Allen, 99 F. Supp. 137, 144 (S. D. N. Y. 1951).

[37] *Cf.* Cherner *v.* Transitron Electronic Corp., 221 F. Supp. 48, 51 (D. Mass. 1963).

pendently of Alleghany's counsel in representing the interests of the Class B minority shareholders. These three plaintiffs and their counsel over a long period have been alert to enforce the rights of Class B stockholders. The lawyers for the plaintiffs in this action also represented them in the Missouri voting rights case and, over Mississippi's strong opposition, successfully upheld the right of the Class B stockholders as a separate group to vote upon consolidations. They are particularly knowledgeable with respect to the basic facts of MoPac and the hard core issues of this litigation; they are especially experienced in this field of law. Additionally, the parties, during the course of the litigation and in the negotiations, had the benefit of the advice of experienced independent railroad investment advisers and analysts. The record leaves no room to doubt that the negotiations were conducted in good faith and at arm's length, with the Class B stockholders represented by sophisticated, if not hardened, negotiators who deem the settlement the best result obtainable without a trial of the issues on the merits.[38]

Finally, the fairness of the settlement is emphasized by the provision that, despite Mississippi's and Alleghany's effective voting control by reason of their respective majority ownership of the class A and B stock, sufficient under MoPac's charter to put through a recapitalization, the Plan cannot be effected without the approval of a majority of the other stockholders of each class[39]—in effect, acceptance of the settlement rests with them regardless of the desires of Mississippi and Alleghany.

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[38] *Cf.* Mutual Shares Corp. *v.* Genesco, Inc., [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶92,315 (S. D. N. Y. 1968); Cherner *v.* Transitron Electronic Corp., 221 F. Supp. 48, 51 (D. Mass. 1963).

The fact that the form of the settlement decided upon is somewhat unusual and that it includes some benefits which cannot be evaluated in financial terms does not militate against its acceptance; the parties are permitted great freedom in shaping the form of settlement consideration. *Cf.* Derdiarian *v.* Futterman Corp., 38 F. R. D. 178 (S. D. N. Y. 1965); Manacher *v.* Reynolds, 39 Del. Ch. 401, 165 A. 2d 741, 747 (Ch. 1960); Levy *v.* Babb, 39 Misc. 2d 648, 241 N. Y. S. 2d 642 (Sup. Ct. 1963).

[39] *Compare* Winkelman *v.* General Motors Corp., 48 F. Supp. 490, 495 (S. D. N. Y. 1942).

The factors militating in favor of the settlement are indeed substantial, but a number of Class B stockholders challenge it as unfair and inadequate.

THE OBJECTIONS

At the hearing on this motion, Class B stockholders or their attorneys appeared and others communicated with the Court by letter to voice their objections to approval of the Plan. There are eighteen objectors who own a total of approximately 1,167 shares.[40] They concentrate their attack on the alleged inadequacy of the exchange for their holdings; its tax consequences; they also contend the settlement is unfair as between them and Alleghany as the majority Class B stockholder. Almost all the objectors agree that the litigation should be settled, but on better terms than those proposed; failing that, they urge rejection of the settlement.

The primary objection is that the package exchange of $850-16 shares of new common stock for each share of present Class B stock yields substantially less than the value of the shares to be surrendered. The substance of this challenge rests principally upon the existing rights of the Class B stock as against those of the Class A stock. A major premise in the objectors' attack is their view that realistically the Class A stock is a noncumulative preference stock limited to a $5 per year dividend and to $100 per share upon liquidation; that realistically the Class B stock is the common stock entitled to unlimited dividends as may be declared and to all MoPac's equity above the $100 per share attributable to the Class A stock. These differences are the hard core of the objectors' valuation and other contentions. However, merely to state the differences in rights between the two classes of stock is

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[40] The 39,371 outstanding Class B Shares are held by some 950 individuals or corporations. That a comparatively small number of holders of shares reflecting a small percentage of the total outstanding oppose, as against a great majority who favor, the settlement does not relieve the Court of its function in passing upon the fairness of the proposal. *See* Protective Comm. *v.* Anderson, 390 U. S. 414, 435 (1968); *cf.* American United Mutual Life Ins. Co. *v.* City of Avon Park, 311 U. S. 138 ,148 (1940).

too simplistic an approach; countervailing factors cannot be ignored. A factor of force is that the Class A stock, whether termed a "preference" or "hybrid" stock, or otherwise, has one vote per share, just as each share of Class B stock, with the result that the Class A stock not only controls the management of MoPac, but also can and, as plaintiffs charge, does exercise this control to withhold dividends from the Class B stock, whereas the Class B stock, a small minority of all outstanding shares, has the veto power over mergers, consolidations and other important corporate actions, and yet it is without sufficient voting strength to elect even one director. Another countervailing factor which cannot be disregarded is that the Class A stock, while noncumulative, is entitled to receive dividends out of retained earnings in each year even if current earings for a particular year may be insufficient to cover dividend requirements on the A stock. Consideration of the objectors' contentions with respect to the value of their stock cannot ignore these elements. Thus we turn to the specific objections.

Almost all the parties are in accord that the new common shares can be valued at about $100 per share, so that the $850-16 share package conversion rate equals approximately $2,450 for each present Class B share. But objectors and proponents differ on the present value of the B stock, as well as the A stock. It would serve no useful purpose to analyze in detail their computations whereby they evaluate the present worth of each class. Their differing estimates derive from the methods used to value the shares.

Most objectors evaluate the shares by their book value. Several apply the capitalization of net earnings method; in this instance, they allocate to the Class B stock all of MoPac's annual net earnings above the annual Class A dividend requirements. Their position is that the earnings of the Class A stock cannot exceed its maximum dividend, that is $9,319,000, or $5 per share, and consequently the balance of each year's earnings should be allocated to the Class B stock. By their respective methods the objectors calculate that the present worth of each share of Class B stock ranges from somewhat over $4,000 to the unrealistic, if not astronomical, figure of $25,000. Those

objectors who capitalize net earnings as allocated by them to the Class B stock estimate, at a price-earnings ratio of 10-1, its value at $4,450 per share. At a 9-1 ratio, it would be $4,005 per share (1972 earnings).

The proponents, in evaluating the present worth of the two classes of stock, also apply the capitalization of recent earnings method (1971-1972). However, their method of allocation of earnings differs from that of the objectors. Instead of deducting the Class A maximum annual dividend requirement from net earnings, the proponents take into account the market value of the Class A stock which, shortly before the announcement of the settlement, was selling between $70-75 per share.[41] They capitalize MoPac's earnings for the two years on a 9-1 basis, resulting in its capitalized value of $225,000,000 to $243,000,000. The market value of the Class A stock is deemed its true value, and accordingly its aggregate market value is deducted from MoPac's capitalized value and the difference allocated to the Class B stock, with the end result that the Class B stock is valued at an average of $2,365 per share; a 10-1 capitalization rate would bring the average value somewhat higher.

Before considering the respective contentions, it is desirable to emphasize the Court's function on this application, already referred to; particularly so, since a number of objectors advance their arguments of stock valuation as if this were a proceeding under section 77 of the Bankruptcy Act,[42] where the phrase priority rights of senior securities owners on the basis of full compensatory value. The Court here is not called upon to make a definitive assessment of the value of each class of stock, old or new—that is not even a requirement were the proceeding one under section 77,[44] where with its standard of "fair and equit-

[41] Consideration was given to the effect of the public announcement of the proposed settlement.

[42] 11 U. S. C. § 205.

"fair and equitable," a term of art,[43] requires recognition of

[43] Case *v.* Los Angeles Lumber Prods. Co., 308 U. S. 106, 115 (1939).

[44] *See* Group of Institutional Investors *v.* Chicago, M., St. P. & Pac. R. R., 318 U. S. 523, 564-65 (1943).

able," it is recognized that "the pretenses of exactitude" in determining a dollar value for a railroad property is somewhat illusory.[45] The Court here is concerned with a proposed settlement of a lawsuit and whether its terms, taking into account the probabilities of success upon a trial, and all pertinent factors, are "fair, reasonable, and adequate . . . terms [that] are general and cannot be measured scientifically."[46] In passing upon a proposed settlement of a stockholder's litigation, the standard "fair, reasonable and adequate" is not to be equated with "fair and equitable," applicable to a proposed railroad reorganization under the Bankruptcy Act. In the compromise of a stockholder's lawsuit there necessarily come into play "practical adjustments,"[47] elements of give and take by the respective interested parties, depending upon their strengths and weaknesses in the litigation;[48] and, of course, the uncertainty of its outcome, as well as the rewards, if successful, are important considerations in the process of compromise and concession.

First, as to book value as a method of valuation. The authorities are in agreement that book value is of little significance in appraising the value of stock; that what is of prime significance is a corporation's earning potential based on past experience.[49] The contention made by the objectors as to the change in equity between the two classes of stock is related to the book value concept. There appears to be no dispute that should the new preferred (1,864,052) shares be converted into new common, the equity position of the B stockholders would be reduced from 61½% to 25½%. The objectors and proponents differ as to

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[45] *Id.* at 565.

[46] West Virginia *v.* Chas. Pfizer & Co., 314 F. Supp. 710, 740 (S. D. N. Y. 1970), *aff'd,* 440 F. 2d 1079 (2d Cir.), *cert. denied,* 404 U. S. 871 (1971).

[47] *Cf.* Group of Institutional Investors *v.* Chicago, M., St. P. & Pac. R. R., 318 U. S. 523, 565 (1943).

[48] *See* Masterson *v.* Pergament, 203 F. 2d 315, 330 (6th Cir.), *cert. denied,* 346 U. S. 832 (1953); Percodani *v.* Riker-Maxson Corp., 50 F. R. D. 473, 477 (S. D. N. Y. 1970).

[49] *Cf.* Ecker *v.* Western Pac. R. R., 318 U. S. 448, 483 (1943); Consolidated Rock Prods. Co. *v.* Du Bois, 312 U. S. 510, 525-26 (1941).

the importance of the shift in equity. The terms equity and book value are essentially synonymous.[50] They would have relevance if there were the prospect of MoPac's liquidation[51] or a takeover of the railroads by the government. Neither liquidation nor the nationalization of the railroads of the country is an imminent likelihood. Judge Learned Hand's sage observation of the fallacy of measuring the value of shares by their book value is as sound today as when he stated it almost fifty years ago:

> "The suggestion that the book value of the shares is any measure of their actual value is clearly fallacious. It presupposes, first, that book values can be realized on liquidation, which is practically never the case; and, second, that liquidation values are a measure of present values. Everyone knows that the value of shares in a commercial or manufacturing company depends chiefly on what they will earn, on which balance sheets throw little light. . . ."[52]

Next, as to the capitalization of earnings method, it has been already noted that the difference in valuation between objectors and proponents of the Class A and Class B stock results from different methods of allocating earnings to the two. Since the matter is one of judgment, there is room for disagreement. The Court has examined the submissions of the parties on this subject and is persuaded that the method of valuation, which takes into account the market value of the Class A shares and the underlying factors in its support offered by an expert retained to give an independent evaluation, is of substance and merits consideration.[53] The expert, after taking into account the mar-

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[50] *See* Accountants' Handbook § 3, at 11 (R. Waxon ed. 1965); Prentice-Hall Encyclopedic Dictionary of Business Finance 78-79, 237 (1960).

[51] MoPac's financial expert is of the view that were the corporation to liquidate it would probably be in such poor financial condition that no equity would be available for distribution to stockholders. Affidavit of F. L. Lee Jones, Jan. 23, 1973, at 6.

[52] Borg *v.* International Silver Co., 11 F. 2d 147, 152 (2d Cir. 1925).

[53] Affidavit of F. L. Lee Jones, Jan. 23, 1973.

ket value of the Class A stock, valued the Class B stock at $2,365 per share.[54]

The Class A stock is listed on the New York Stock Exchange, is traded in a broad market, and almost 700,000 shares are held by the public. With an active market for the Class A stock, it cannot be said that to ascribe the market price as its fair value is unreasonable. The market evaluation of a stock may reflect a more realistic appraisal of its value than a conceptual evaluation. Theory must yield to the reality of the market place, "the true appraiser."[55] Indeed, to quote Judge Learned Hand again: "When all is said, the value is nothing more than what people will pay for. . . ."[56]

The Class B stock is traded on the over-the-counter market; the market is thin; and the traders are few. The market for the Class B stock has never approached the values urged by the objectors. The range has been between $1,100 and $2,500 per share.[57] The conclusion is warranted that the public market, in pragmatic terms, has taken into account MoPac's unusual capitalized structure, whereby a so-called preference stock has voting rights that control not only MoPac's management, but also its

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[54] Alleghany's chief financial officer also took into account the market value of the Class A stock in appraising the value of the Class B stock and reached approximately the same valuation. Affidavit of John J. Burns, Jan. 22, 1973.

[55] New York, N. H. & H. R. R., 1st Mtg. 4% B. C. *v.* United States, 305 F. Supp. 1049, 1069 (S. D. N. Y. 1969) (Weinfeld J. dissenting), *vacated sub nom.* New Haven Inclusion Cases 399 U. S. 392 (1970).

[56] Borg *v.* International Silver Co., 11 F. 2d 147, 152 (2d Cir. 1925).

[57] While the Class B stockholders contend that the market price of their stock has been depressed by the acts of the defendants, we deal with the fact situation as it exists. Whether the market price of the Class B shares is the consequence of defendants' alleged conduct is one of the issues to be decided were the case to go to trial. Similarly, objections directed at the failure of MoPac to report the earnings allocable to the B shares, as to which defendants offer an explanation, also go to the merits of plaintiffs' claim, not to the fairness or adequacy of the settlement.

dividend policy with the power to withhold dividends from the Class B stock, and accordingly appraised the value of the two classes of stock based upon their respective power, rights and restrictions.

Another factor suggests that the proponents' experts' valuations are closer to the mark than the objectors' valuations. Alleghany, as the majority owner of the Class B stock, has, through through the years, been the principal antagonist to Mississippi, the majority owner of the Class A stock. Widely divergent views as to the B stock's value have, up to the present, foreclosed any compromise. Alleghany's acceptance of the settlement as a disposition of their longstanding controversy during which it has spent millions to protect its investment may be said to reflect a realistic recognition of the true value of the Class B shares. If the objectors' evaluation of $4,000 or more per share is sound, then Alleghany, owning in excess of 21,000 shares, has, after many years of litigation, suddenly given up the ghost and yielded more than $40,000,000[58]—hardly a likelihood in view of the history of events and the sophistication of its financial executives and advisers.

Also, it is not without significance that objector Garfield's securities expert, who on the capitalization of earnings method fixes a value of "over $4,000" a share for the Class B stock, nonetheless concludes "that if the impasse between the Class A and the Class B is to be settled, there must be a compromise at a lower figure to reflect the lack of voting control of the Class B"[59]—another way of saying that any evaluation of the stock must make allowance for its encumbered status. Obviously that compromise figure cannot be a matter of mathematical precision; it need not be; it is a matter of judgment based upon a consideration of factors pro and con, some of which have been adverted to above. This Court is satisfied that the package of

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[58] Even assuming objector Garfield's contention as to tax consequences is correct (*see* p. 47 *infra*), an alleged tax benefit of $4,000,000 to Alleghany under the part cash payment plan would hardly justify giving up $40,000,000.

[59] Affidavit of David M. Day, Jan. 30, 1973, ¶5.

$850-16 shares common stock in exchange for each Class B share cannot be said to be inadequate, especially so when considered as a compromise.

However, the objectors argue that even so, the plan is unfair in that the compromise should be only in terms of new common stock and not include any cash payment. They contend that the $850 cash payment per share will be taxed as ordinary income, and with their individual income situations they will be subjected to high surtax rates, whereas Alleghany, by reason of its corporate structure, faces, with respect to the cash payment, a 7.2% rate. Objector Garfield contends that under the cash-stock exchange, Alleghany will benefit by over $4,000,000 in comparison with an all stock plan. Several alternative plans, including a tax free exchange (24½ shares of new common instead of the $850-16 shares for each Class B share) are proposed by objectors as being more equitable. Many of these suggestions were considered during the course of the extended negotiations. One such plan envisaged giving the minority Class B stockholders an option to receive all stock (24½ shares) in exchange for each Class B share instead of the $850-16 share package. However, based upon the opinion of independent tax counsel retained especially by the Class B representatives, other than Alleghany, this alternative was rejected since its tax consequences were potentially more unfavorable than those under the cash and stock exchange. Independent tax counsel was of the view that such an option would have exposed a substantial portion of the shares to ordinary income tax treatment.

Another approach would have eliminated the cash payment and given only stock to all Class B stockholders, including Alleghany. This proposal met with rejection because it would lower Mississippi's degree of control below its present level and further could fail to eliminate the present divided control within MoPac since Mississippi would control the preferred but not necessarily the common. To assure elimination of the divided control, as well as the friction and litigation it has engendered, Mississippi deems it essential that it have a substantial majority interest in both classes of stock. This accounts for its cash tender offer

to purchase not less than 400,000 shares of new common at $40,000,000 and Alleghany's commitment to tender all its 339,888 shares of new common stock upon their receipt. Additionally, the proposal would place Alleghany in a minority position without real control over its investment and deprive it of the veto power it now has as the majority owner of the present Class B stock. Neither Mississippi nor Alleghany was amenable to this situation. Objector Garfield's suggestion that if Mississippi desires to retain its present degree of stock control that it purchase the additional shares of the new common stock to be issued to Alleghany under an all stock exchange would require Mississippi to expend, in addition to its present commitment of $40 million cash, another $20 million, an added obligation it is not prepared to assume.

Whether or not the reasons for rejection of the alternative proposals were justified is not the question before this Court, which is called upon to decide whether the settlement reached by the litigants and submitted for approval is fair and reasonable. The discharge of this function does not require the Court to reopen negotiations in an effort to secure more advantageous terms, which plaintiffs, in sophisticated and arms length bargaining, were unable to secure for themselves and the class they represent. Taxes are taxes; the rates are fixed by Congress; they cannot be adjusted in particular cases to accommodate an individual taxpayer's obligation as to income derived from the settlement of a lawsuit. The tax will vary in the instance of each Class B stockholder dependent upon his particular bracket, and even corporations other than Alleghany, which may own Class B stock, will face varying tax payments. The fact is that two-thirds of the conversion package is tax free. Moreover, were the case to proceed to trial and plaintiffs secured a judgment declaring the Class B stockholders entitled to dividends in given years, the entire proceeds received by each shareholder would be taxed as ordinary income. Under all these circumstances, it cannot be said that the $850 cash payment constituting part of the conversion rate is unfair.

Other Objections

Several objectors question the adequacy of the notice of the proposed settlement given to stockholders, which was mailed to each registered stockholder and published in the Wall Street Journal (National Edition). The objections go to the contents of the notice. However, it sufficiently informed any interested stockholder of the nature of the pending action, the general terms of the settlement, that complete and detailed information was available from the files of this Court, and that any stockholder could appear and be heard at the hearing; in sum, the notice fairly apprised the members of the class of the pertinent terms of the proposed compromise and the significance of the entry of a final judgment approving the settlement.[60]

Two Class A stockholders of fifty shares object because the settlement is contingent upon Mississippi's ability to finance its tended offer obligation, and therefore, "if such financing is not available, the parties will have gone to considerable expense . . . to no good purpose." However, Mississippi already has secured a formal commitment of financing which has been found satisfactory by Alleghany and its counsel.[61] The same objectors also express concern over the possible effects of the cash payout upon MoPac's financial structure. MoPac has represented that this presents no problem to a railroad of its size.[62]

A MoPac debenture holder has raised a question as to possible impairment of the rights of debenture holders. Under the terms of the settlement, an opinion of MoPac's counsel is required to the effect that none of the transactions are in breach or in default of any of the provisions of any indenture or other

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[60] *Cf.* Air Lines Stewards Local 550 *v.* American Airlines, Inc., 455 F. 2d 101, 108 (7th Cir. 1972); *see* United Founders Life Ins. Co. *v.* Consumers Nat'l Life Ins. Co., 447 F. 2d 647, 654 (7th Cir. 1971); *see also* Winkleman *v.* General Motors Corp., 48 F. Supp. 490, 494 (S. D. N. Y. 1942).

[61] Defendant's Supplemental Reply Memorandum at 5-6; Hearing Minutes at 41-42.

[62] *See* Jones Affidavit at 5; Affidavit of Downing B. Jenks, Jan. 22, 1973, at 10.

instrument binding upon MoPac. It is represented to the Court that MoPac's counsel upon a review of all documents is prepared to render such an opinion.

Objections are made to fees requested by attorneys representing the respective plaintiffs. To the extent that such allowance may be granted, the parties are to be paid equally by Mississippi and MoPac. However, the fee applications are, in the event of acceptance of the settlement, subject to approval by the Court and a separate hearing, notice of which will be given to all interested parties, at which time any objections may be presented to the Court.

Conclusion

This Court, after thorough consideration of all pertinent factors and of the extensive contentions of the objectors and proponents with respect thereto, and weighing the benefits to be derived from the settlement against the alternative of a continuance of this litigation, with its outcome doubtful, and, even if successful, the uncertainty of any meaningful recovery, concludes that the settlement falls within a "range of reasonableness"[63] that warrants its approval. In sum, it offers a permanent solution to the longstanding impasse between the two contending groups of stockholders—a result that cannot be achieved through successful litigation. Indeed, continued litigation may be said to be an exercise in futility since the hard core of the cause of the differences between the two groups would remain and continue to plague them and MoPac. The settlement will afford MoPac the opportunity to pursue merger prospects so vital to its economic growth and existence and to permit its officials to give full time and attention to corporate affairs. Also it means the prospect of greater annual dividends to the Class B stockholders; a broader market for their shares; and the opportunity for representation on the Board of Directors. Even were it to be found

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[63] *See* Newman *v.* Stein, 464 F. 2d 689, 693 (2d Cir.), *cert. denied* —— U. S. —— (1972); see also United Founders Life Ins. Co. *v.* Consumers Nat'l Life Ins. Co., 447 F. 2d 647, 655-56 (7th Cir. 1971).

that the Class B stock approached the approximate $4,000 value per share as estimated by a number of objectors, the settlement still would come within a range of reasonableness and warrant approval. Finally, if a majority of the minority Class B stockholders are of the view that the advantages of the settlement are insufficient to compensate for what they believe to be the value of their shares, they have the power to reject it.

The settlement is approved and judgment may be entered accordingly.

Dated: New York, N. Y.
March 19, 1973

United States District Judge
EDWARD WEINFELD

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No. 73-663

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

BETTY LEVIN, ALLEGHANY CORPORATION and ROBERT LEVASSEUR,
Plaintiffs-Respondents,

—against—

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS F. MILBANK,
Defendants-Respondents,

WILLIAM R. WESSON,
Petitioner.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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IN THE

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OCTOBER TERM, 1973

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ROBERT H. CRAFT, T. C. DAVIS
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Petitioner.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

This brief is submitted by respondents, being all of the parties to the original action, in opposition to the petition for a writ of certiorari submitted by William R. Wesson, a member of the plaintiff class and objector to the settlement approved by the District Court and affirmed by the Court of Appeals.

Opinion Below

The opinion of the District Court for the Southern District of New York approving the settlement of this action is reproduced commencing at A 4 of the Petition, and is reported at 59 F.R.D. 353 (S.D.N.Y. 1973). The judgment of the Court of Appeals for the Second Circuit affirming the judgment of the District Court upon the opinion of the District Court is reproduced at A 2 of the Petition.

Questions Presented

1. In a class and derivative action, does the District Court have power under Fed. R. Civ. P. 23(e) and 23.1 to approve a settlement negotiated by the parties which not only resolves the issues in dispute but also the fundamental conflict between the parties which gave rise to the action?

2. In a suit primarily to compel the payment of dividends to a particular class of stockholders, are the holders of that class of stock an appropriate class under Fed. R. Civ. P. 23(a), (b)(1) and (2), all members of which will be bound by a judgment entered by the District Court pursuant to Fed. R. Civ. P. 23(e) dismissing the complaints with prejudice?

REASONS FOR DENYING THE PETITION

The Petition misstates and misconceives the issues involved in this action, which are carefully and concisely set forth in the opinion of the District Court approving the settlement of this action. Stated simply, this action was commenced on behalf of all Class B stockholders of Missouri Pacific Railroad Company ("MoPac") to compel the payment of dividends to that class. In 1968 the action

was determined to be a class action pursuant to Fed. R. Civ. P. 23(a), (b)(1) and (2), binding upon all Class B stockholders of MoPac.

In 1972 the parties to the action effected a settlement agreement which includes a plan of recapitalization for MoPac. (R. Doc. 5)* Approved by the MoPac stockholders, the recapitalization will effectively eliminate the cause of dispute which resulted in this suit for dividends, a result which could not have been achieved by litigation. The District Court in approving the settlement found the plan "fair, reasonable and adequate" to the Class B stockholders and to MoPac.

1. Contrary to the petitioner's assertion (Pet., at 6), the recapitalization was not "ordered" by the District Court; rather, MoPac was *permitted* to submit a plan of recapitalization to its stockholders for their vote, which, if approved, would result in a settlement of the litigation. In doing so, MoPac not only adhered to this Court's earlier decision** requiring a separate class vote on major corporate action, but went further and submitted the plan to its stockholders subject to a majority vote of the minority of each class.***

On June 15, 1973, three days after the Court of Appeals had summarily affirmed the judgment of the District Court and refused to stay the MoPac stockholders' meeting, the stockholders of MoPac overwhelmingly approved the plan of recapitalization. MoPac also has applied to the Interstate Commerce Commission for authority to issue the new shares contemplated by the plan, a full and complete hearing was held before the I.C.C. in September of this year, and a decision is now pending.

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* The settlement agreement is also printed as an attachment to the MoPac Proxy Statement, R. Doc. 29. That agreement provides, in paragraph 7.7 thereof, that the agreement may be terminated by any party if the recapitalization is not concluded by December 31, 1973.

** *Levin* v. *Mississippi River Fuel Corp.*, 386 U.S. 162 (1967).

*** See Proxy Statement, R. Doc. 29, at p. 2.

Petitioner stands in no different position from any other stockholder who opposes corporate action supported by most of the stockholders. Any injury which he might incur is not the result of any action by the federal courts, but of the process of corporate democracy. Any remedy available to him by way of appraisal or otherwise is not denied to him by the judgment of the court below but arises if at all under Missouri law and should be asserted in the Missouri courts.

2. The judgment of the District Court is binding upon all members of the class, but only to the extent that they are barred from commencing a new action to compel the payment of dividends. Pursuant to the settlement, as approved by the District Court, the complaints in this case were dismissed with prejudice, and that dismissal is binding upon all members of the class. Because any relief which might have been obtained in litigation compelling MoPac to pay additional dividends to the Class B stockholders would necessarily have had to benefit every member of the class, the District Court held in 1968 and reaffirmed in 1973 that this case is a class action on behalf of all Class B stockholders, without a right by any member of the class to seek exclusion.

It is beyond question that an action to compel the payment of dividends is appropriate for class treatment. Indeed, this particular type of suit is specifically mentioned in the Notes of the Advisory Committee on the Federal Rules with respect to amended Rule 23, which states that a stockholder's action to compel declaration of a dividend should ordinarily be conducted as a class action within Rule 23(b)(1). Notes of Advisory Committee on Federal Rules, 28 U.S.C.A., Fed. R. Civ. P. Rules 17 to 23.1, at 297.

This action was also properly determined to be a class suit under Rule 23(b)(2), in that it sought a mandatory injunction governing future dividends in a case where MoPac had "acted or refused to act on grounds generally applicable to the class . . ." and MoPac could not as a matter of corporate law declare dividends on some but not all of its Class B Stock.

The opinion and decision of the District Court was clearly correct, involves no substantial question of federal law and does not in any other respect present a question justifying the granting of the petition by this Court. Accordingly, the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be denied.

October 26, 1973

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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-663

WILLIAM R. WESSON, a CLASS B STOCKHOLDER in MISSOURI PACIFIC RAILROAD COMPANY, for himself and all others similarly situated,

Appellant,

v.

BETTY LEVIN, on behalf of herself and all other holders of CLASS B COMMON STOCK of MISSOURI PACIFIC RAILROAD COMPANY, and on behalf of said corporation, and ROBERT LE VASSEUR and ALLEGHANY CORPORATION,

Plaintiffs-Appellees,

against

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS MILBANK,

Defendants-Appellees.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

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v.

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Plaintiffs Appellees,

against

MISSISSIPPI RIVER CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, ROBERT H. CRAFT, T. C. DAVIS and THOMAS MILBANK,

Defendants Appellees.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

William R. Wesson, a Class B stockholder in Missouri Pacific Railroad Company (Mo Pac), on behalf of himself and all others similarly situated, petitions this Honorable Court, pursuant to

its Rule 58(2) for a rehearing of his prior petition to this court for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit, said prior petition having been dated October 17, 1973, and denied by this Court by an Order entered December 17, 1973.

Proceedings Below

The Plaintiffs-Appellees, as Class B stockholders of Mo Pac, on behalf of themselves and all other Class B stockholders similarly situated, maintained a class action under Rule 23(a), (b)(1) and (2), [Fed. Rules of Civil Proc.], in the United States Federal District Court (S. D. N. Y.), against the Defendants-Appellees, basing the jurisdiction of the Court on diversity of citizenship, (Title 28 U. S. C. 1332).

The thrust of the complaint below was directed toward the dividend policy with respect to the Class B stock, which the Plaintiffs-Appellees claimed was inadequate and too low.

The Class B stockholders owned the equity of Mo Pac, but represented only 2% of the voting stock. The Class A Stockholders were limited to only a $5 non-cumulative annual dividend when and if earned and declared, plus $100 per share on dissolution or liquidation, with no further participation in the equity of Mo Pac. Class A stockholders controlled 98% of the voting stock, and had the power to elect Mo Pac's Board of Directors and determine dividend policy with respect to the equity owners —Class B stockholders. In essence the Class B stockholders were the common stock equity owners, and the Class A stockholders were in reality non-cumulative preferred stockholders with voting control. [Reorganization Plan of Mo Pac effective March 1, 1956; Missouri Pac. R. R. Reorganization 290 I. C. C. 477 (1954), approved in In Re Missouri Pac. R. R., 129 F. Supp. 392 (E. D. Mo.), aff'd sub nom. *Missouri Pac. R. R. 5¼% S. B. C.* v. *Thompson,* 225 F. 2d 761 (8th Cir. 1955), cert. denied 350 U. S. 959 (1956).]

The defendants-appellees includes, in addition to Mo Pac and its directors, Mississippi River Corporation which in 1973

owned 63% of the voting Class A stock, and was alleged below to have misused its majority voting stock to starve the Class B stockholders, and to deprive them unjustly of proper dividends on their equity holdings.

Four years after the action below for better dividends was declared a Class action, the plaintiffs-appellees entered into a stipulation of settlement with the defendants-appellees, which settlement had nothing to do with the claim for dividends, but called for a total recapitalization of Mo Pac., something far removed from and foreign to the pleadings in the pending litigation below. The plaintiffs-appellees by this settlement abandoned their original claim or cause of action for better dividends, which was held as a trust for the petitioner and other Class B stockholders purportedly represented by the plaintiffs-appellees.

But far worse than abandonment of the class cause of action the settlement required that the represented class of Class B stockholders give up their ownership of their Class B stock, reduce their equity in Mo Pac's assets as of December 31, 1972 from 65.5% to 25.5% and transfer it to the Class A stockholders so that the latter's equity might be increased from 34.5% to 74.5%, and to accept under the recapitalization plan $850 and 16 shares of new common with stated value of $6.25 per share for each share of Class B stock, without any right to have the said stock evaluated under proceedings of due process for its actual value. All of this 61% loss of equity as of December 31, 1972 was given up by the plaintiffs-appellees, and the burden was placed on the petitioner and other represented Class B stockholders with absolutely no counterclaim or pretext of a counterclaim on the part of the defendants-appellees that they had a right to such benefits or right to recapitalization.

On May 2, 1973, the Federal District Court (S. D. N. Y.) by judgment, over the protest of the petitioner, and having denied the motion of petitioner on behalf of himself and others similarly situated that he not be bound by the said settlement, approved the said stipulation of settlement.

The United States Court of Appeals (2nd Circuit), approved the judgment of the District Court, without opinion but upon the opinion of the District Court.

Controlling Intervening Factors Which Warrant Rehearing

Aside from the dire need for clarification and guide lines as to the application of Rule 23e, (F. R. C. P., as to Compromise of a Class Action), so as to insure that the settlement of a non-true class suit has some fair and reasonable relation to the pleadings and issues in litigation, and does not compel the represented members to give up property rights which are not involved in the litigation, petitioner advances three reasons why this Honorable Court should rehear his prior petition for Certiorari.

FIRST: In the recent decision of this Court in *Zahn et al* v. *International Paper Company*, Cert. 72-888, argued October 16, 1973, decided December 17, 1973, it was established that each member of a class action, formerly known as spurious, the jurisdiction of which is based on diversity of citizenship, must have a claim meeting the jurisdictional amount of $10,000, (Title 28 U. S. C. 1332) exclusive of costs and interest.[1]

In the instant case, which was a suit the thrust of which was for better dividends, 76.1% of the Class B stockholders who were represented by the plaintiffs appellees owned 10 or less shares of Class B Mo Pac stock. By no stretch of the imagination could these represented stockholders meet the jurisdictional amount, and hence the District Court had no authority to enter judgment affecting their property rights in ther stock. This is so

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[1] This is a spurious class action because the right of the various Class B stockholders in the controversy was not joint but several. Moreover, many, if not most, of the Class B stockholders bought their stock for capital appreciation rather than cash dividends; otherwise they would not have paid from $700 to $2,500 per share for a stock paying a $5 per annum dividend. Clients of the appellant, Mr. Wesson, a stock and bond broker, and Mr. Wesson himself bought the Class B stock for capital appreciation because of its large earning power and because the 1956 Reorganization Agreed Plan made the Class B stock "The residuary beneficiary of any future prosperity the property may enjoy." 290 ICC 477 at 625. Finance Docket No. 9918. The Class B stock earned approximately $448 in 1972, using ICC accounting rules and after the maximum $5 per share dividend paid to Class A. The 1973 earnings are running substantially higher than 1972.

aside from the fact that these property rights were not in jeopardy in the litigation below and not within the jurisdiction of the District Court in any event.

A review of the Class B stockholders list of Mo Pac, at or about the time of the judgment below, reveals the following about the 922 Class B stockholders as of May 1, 1973:[2]

No. of Class B Shares Owned	Approx. No. of Class B Stockholder Owners	Percentage of Total Class B Stockholders
1 share	197	21.4%
2 shares	113	12.25%
3 shares	64	6.93%
4 shares	18	1.95%
4 or less	392	42.5%
5 or less	558	60.5%
10 or less	701	76.1%

The dividend being paid to the Class B stockholders at the time of the suit was $5 per share per year. The complaints of the plaintiffs-appellees were not clear as to how much the dividends should be, but it would unduly stretch the imagination to pretend that a holder of 5 or less shares of Mo Pac Class B stock had $10,000 involved in the controversy.

The Zahn case, (supra), coming from the 2nd Circuit, should have controlled, and the judgment of the District Court could not and should not be binding on the Class B stockholders who lacked the jurisdictional amount of $10,000.00. Because this honorable court held in Zahn that such an amount was jurisdictional and not procedural, it logically should make no difference whatsoever that the class in Zahn was pursuant to Rule 23(b)(3), (F. R. C. P.), and the class in the instant case was pursuant to Rule 23(a)(b)(1) and (2) (F. R. C. P.). In both cases the rights of the members of the class were several and not joint.

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[2] When Hon. Judge VAN PELT BRYAN issued his class action order on October 9, 1968, there were "approximately 1,200 holders of Class B;" and Alleghany Corporation was beneficial owner of 20,732 Class B shares of the total 39,731 Class B shares outstanding.

SECOND: Alleghany Corporation, the holder of 53% of Class B Mo Pac stock purported to "fairly and adequately protect the interests of the class" of Class B stockholders of which petitioner is one. (Rule 23(a)(4) F. R. C. P.).

However unknown to the petitioner, until recently through the ICC hearings on the instant recapitalization of Mo Pac as approved by the Courts below, Alleghany had been previously authorized by the ICC to acquire the Jones Motor Co. Inc. [Alleghany Corporation Control and Purchase—Jones Motor Co., Inc.—and Control Erie Trucking Company No. MC-F-10444, 109 MCC 333, decided January 27, 1970; cf. Inadequacies of Protection for Investors in Penn Central and Other ICC-Regulated Companies—Staff Study for the Special Subcommittee on Investigations of the Committee on Interstate and Foreign Commerce, H. R. 92nd Congress, July 1971 Staggers Committee, Gov't Print. O. 59-2970 pages 36-38].

This acquisition of Jones by Alleghany was commenced as early as September 4, 1968 and was consummated by April 30, 1970.

The ICC in its decision of January 27, 1970 conditioned its approval of the Jones acquisition by Alleghany so that "the trustee-ship of Alleghany's Mo Pac securities as previously ordered by the Commission, be continued subject to the continuing jurisdiction of the Commission". (109 MCC 333, 350).

On October 6, 1973 Alleghany, through its attorney, filed a brief with the ICC seeking the ICC's approval of the recapitalization of Mo Pac as provided for in the settlement agreement of the judgment of the court below in the instant case. Alleghany argues in that brief that the divestiture of its (Alleghany's) interest in Mo Pac Class B stock would be in keeping with the public interest, the prior order of the ICC, (Jones Motor Co. Inc., supra 109 MCC 333), would save Alleghany from great financial injury, and relieve the ICC of the burden of supervision of the trust of Alleghany's Mo Pac stock.

From the above, two things are clear: (1) that Alleghany, contrary to its position as a class representative, had such an

over-riding self interest in divesting itself of its Class B stock by the recapitalization plan, that it could not and did not fairly represent the rights of the petitioner and others similarly situated as required by Rule 23(a)(4) (F. R. C. P.).

(2) That Alleghany was not the real party in interest to enter into the stipulation of settlement calling for the recapitalization of Mo Pac because Alleghany's Class B Mo Pac stock was at that very time in trust under "the continuing jurisdiction of the Commission" (ICC) (109 MCC 333, 350 Jones Motor Co. supra). At the very least the prior approval of the ICC should have been obtained before Alleghany signed the stipulation of settlement and/or the District Court rendered judgment approving it. The settlement of the case below went beyond the claim for dividends, (in fact abandoned that claim), and called for recapitalization of an interstate railroad, Mo Pac, something of special concern to the ICC, and because of such concern Alleghany's Mo Pac stock was at that time under the continuing jurisdiction of the ICC.

From the opinion of the District Court below it is clear that the court was unaware that Alleghany's self-interest in disposing of its Class B stock was paramount, and was not representative or beneficial to petitioner and other Class B stockholders. The District Court stated: "Alleghany's self-interest as the owner of 53% of the Class B stock gives some assurance that it negotiated to obtain the best possible terms for that group vis-a-vis the Class A stockholders". "If the objectors evaluation of $4,000 or more per share is sound, then Alleghany, owning in excess of 21,000 shares, has after many years of litigation, suddenly given up the ghost and yielded more than $40,000,000—hardly a likelihood in view of the history of events and the sophistication of its financial executives and advisers" (Pages A21 and A29 respectively from appendix of petitioner's original petition for Certiorari October 17, 1973, Cert. 73-663).

A reading of the Staggers Committee Report (supra), the ICC record on the Jones acquisition by Alleghany (supra) plus Alleghany's filed brief with the ICC in October 1973, would reveal why Alleghany did give up the ghost and was anxious to

dispose of its Class B Mo Pac stock in bulk at any price. Essentially it had to do with substantial tax benefits to be derived for Alleghany by avoiding a 70 percent penalty tax if it were firmly considered a motor carrier under the jurisdiction of the Interstate Commerce Commission, rather than an investment corporation under the jurisdiction of the Securities Exchange Commission. In spite of this fact Alleghany still controls Investors Diversified Services which is now the largest mutual fund complex in the United States with assets in excess of $6 billion.[3][4] For the tax benefit interest of Alleghany, the rights of the petitioner and Class B stockholders, supposedly represented by Alleghany, had to be sacrificed.

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[3] One of the primary reasons presented by Alleghany for acquisition of the operating rights of Jones is to lessen its tax burden. Such burden arises from the fact that Allan P. Kirby, as of February 28, 1969, was the beneficial owner of 4,084,813 shares, or 56.21 percent of the outstanding common stock of Alleghany. Alleghany is, therefore, for Federal income tax purposes, considered a personal holding company since one person (less than 5 individuals) owns more than 50 percent of its stock and has "personal holding income," (60 percent or more of adjusted gross income consists of dividends and interest) and is therefore subject to a 70-percent penalty tax on the "undistributed personal holding income." Alleghany does not want to distribute all such income to avoid the tax. With Alleghany the recipient of the operating revenue generated by its Jones Motor Division, it alleges it would be an operating company rather than a holding company for Federal tax purposes. It could then retain and reinvest net earnings and would not be subject to the 70-percent penalty tax. (109 MCC 333, 339)

[4] CHAIRMAN STAFFORD, dissenting: Clearly, Alleghany violated section 5(4) of the act in acquiring the outstanding stock of Jones and Erie without prior Commission approval. While I agree with the majority finding that such a violation will not automatically defeat the transaction, I find nothing in the record to show that overriding public interest warrants its approval. Alleghany's primary purpose in acquiring Jones, and its affiliates, is to lessen its tax burden. The fact that funds conserved by approval of the transaction will be made available for carrier investment by Jones and thus benefit the public indirectly is not what I consider to be of overriding public interest. Jones is a viable, financially sound and well managed corporation and I feel certain that it could continue to adequately serve the public in the future as it has in the past without benefit of Alleghany's tax savings. (109 MCC 333, 356-7)

THIRD: A fair reasonable and legal solution does exist, as proposed by the petitioner below, which would allow Alleghany to dispose of its B stock in bulk at $2,450 per share and leave petitioner and others similarly situated undisturbed in their equity ownership of MO PAC. Alleghany should sell all of its B stock to MO PAC at $2,450.00 per share, which shares would become treasury stock. The Class B stock should be split 20 for 1, leaving the A stock alone giving Mississippi 51.8% voting control and the minority shareholders of the Class A and B Common 48.2% voting control.

This solution is ideal in that it allows for the accomplishment of the legitimate goals of the corporate parties without abusing the property rights of petitioner and other small investors.

The rejection of this proposed solution results in the wrongful taking of other peoples' property for nothing; [B stockholder's equity in MO PAC is reduced from 65.5% to 25.5% under the judgment appealed from]. The question could be raised: was this the intent from the very beginning of the suit below as a class action?

This Case is a Worthy Case for the Courts Consideration

This honorable court has done much to interpret Rule 23 (FRCP) so that large corporate defendants would not be unfairly and unjustly hounded by Class suits.

In the instant case the class suit device has been used to corral innocent and small investors into a box canyon, in order to tie them down by a court judgment. The abuse in this case is that a class suit on several rights, with no Class B interveners permitted after December 20, 1968, started for better dividends, suddenly is switched into a stipulation for recapitalization. The stockholders rights in their stock, which rights were never in jeopardy from the litigation, are now taken away for the benefit of the large corporate stockholder when the Court renders judgment approving the stipulation of recapitalization, as it did so do.

No small investor will be safe if this Court fails to take this case and pronounce some fair and just guidelines as to the proper relationship between the compromise of a class suit and the issues in the litigation.

Conclusion

Petitioner respectfully prays that this Court rehear his petition for a Writ of Certiorari on the following grounds: (1) That by virtue of this Court's recent opinion in *Zahn et al* v. *International Paper Co.* (No. 72-888, argued October 16, 1973, decided December 17, 1973), it is clear that the judgment below could not bind Class B stockholders of Mo Pac whose represented claims did not meet the jurisdictional amount of $10,000.00 exclusive of costs and interests;

(2) That, by recently discovered information Alleghany could not be a proper class representative to stipulate for recapitalization of Mo Pac because, (a) it had a self serving over-riding interest incompatible to the interests of petitioner and others similarly situated, and (b) its stock interests in Mo Pac were under the continuing jurisdiction of the ICC and the ICC was not a party to, nor did it appear in the action below;

(3) That the so called settlement by recapitalization, being so far removed from the issues involved in the original litigation for better dividends, caused the court to lose its adjudicatory power and to make the judgment void; and

(4) That there is a practical reasonable fair solution to the conflicting interests of the parties in this case, which solution avoids the abuse of Rule 23 and avoids the taking of small investors property by big corporations. [Description of the Plan supra p. 9.]

Dated: Brooklyn, N. Y.
January 9th, 1974

Respectfully submitted,

GERARD M. CAREY
Counsel for Petitioner

WILLIAM R. WESSON
Petitioner

Certificate of Counsel

I certify that the within Petition for Rehearing is presented in good faith and not for delay.

Gerard M. Carey
Counsel for Petitioner

Dated: Brooklyn, N. Y.
January 9th, 1974

Certificate of Service

I, GERARD M. CAREY, Counsel to Petitioner, do hereby certify that 3 copies each of the above and foregoing Petition for Rehearing has been deposited in the United States Mail, postage prepaid, on this the 10th day of January, 1974, to the following addressees:

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